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## Rethinking Professional Fees in Chapter 11 Cases

*Everybody talks about the weather, but nobody does anything about it.*<sup>1</sup>

—attributed, perhaps mistakenly, to Mark Twain

*[O]ur system of capital punishment survives because it is built on an evasion. It permits everyone to evade responsibility. A juror is one of twelve, and therefore the decision is not hers. A judge who imposes a jury's sentence is implementing someone else's will, and therefore the decision is not his. A judge on the court of appeals is one of three, or one of nine, and professes to be constrained by the finder of fact, and therefore it is someone else's call. Federal judges say it is the state court's decision. The Supreme Court justices simply say nothing, content to permit the machinery of death to grind on with their tacit acquiescence.*<sup>2</sup>

—David R. Dow

WHEN I THINK ABOUT PROFESSIONAL FEES IN CHAPTER 11 CASES—specifically, those fees paid to lawyers and financial advisors, among others, for representing the debtor-in-possession, a creditors' committee or another official committee, or others paid from the bankruptcy estate—I find myself wavering between the whimsy of the “nobody does anything about it” quote and the somber “built on an evasion” quote. Contrary to what some of my colleagues think, the process for awarding professional fees isn't completely broken,<sup>3</sup> but it suffers from a

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\* Gordon Silver Professor of Law, William S. Boyd School of Law, University of Nevada, Las Vegas. I owe special thanks to my two best editors, Jeff Van Niel and Morris Rapoport, and to Geoff Berman, Chip Bowles, Bernie Burk, Brian Gifford, Jennifer Gross, Michelle Harner, John Hoffman, George Kuney, Lynn LoPucki, Stephen Lubben, Mike Lynn, Nettie Mann, Tom Russell, William Snyder, Ron Stutes, and Charles Tabb for their helpful comments.

1. QuotationsBook.com, <http://quotationsbook.com/quote/41294/> (last visited Apr. 13, 2010).

2. DAVID R. DOW, *THE AUTOBIOGRAPHY OF AN EXECUTION* 218–19 (2010).

3. See, e.g., LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2006); Lynn M. LoPucki & Joseph W. Doherty, *Routine Illegality in Bankruptcy Court, Big-Case Fee Practices*, 83 AM. BANKR. L.J. 423 (2009) [hereinafter *Routine Illegality*] (concluding that the

fundamental evasion of its own: although professionals' fees typically come from the pot of money left over to divide among unsecured creditors,<sup>4</sup> there's no easy

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practices in the process for awarding professional fees is undermining the fee regulatory system imposed by Congress and the integrity of the bankruptcy courts); Lynn M. LoPucki & Joseph W. Doherty, *Rise of the Financial Advisors: An Empirical Study of the Division of Professional Fees in Large Bankruptcies*, 82 AM. BANKR. L.J. 141 (2008) [hereinafter *Rise of the Financial Advisors*] ("[B]y the end of the period our study covered, financial advisors probably were already receiving fees and expenses as high as those paid to attorneys, and . . . financial advisors' fees and expenses were continuing to increase."). There are some marvelous empirical studies of bankruptcy behavior, including several written or co-written by Professor LoPucki, as well as those written or co-written by Professor Robert Lawless and those written by Professor Stephen Lubben. See, e.g., Stephen J. Lubben, *Corporate Reorganization & Professional Fees*, 82 AM. BANKR. L.J. 77, 82–84 (2008) (referring to various studies examining professional fees conducted by Professors LoPucki, Lawless, and Lubben).

4. See, e.g., 11 U.S.C. §§ 101(14), 327, 328, 329, 330, 503, 507, 1107(a) (2006) (providing the landscape in the Bankruptcy Code sections for paying professional fees in Chapter 11 cases). Some fees—notably, the fees for payments of the professionals representing or advising the debtor-in-possession (DIP) or unsecured creditors' committee, when coupled with a cap on fees—can force those professionals to curb their natural instincts as to how vigorously they'll represent their clients' interests. As to this latter point, Professor George Kuney has explained:

[Such carve-outs] set the stage for domination and control of the chapter 11 process by the monied interests—in the large chapter 11 case, the secured creditors and DIP lenders—regardless of how much process, how many duties, and how many powers were granted or thrust upon unsecured creditors, their committees, or the office of the United States Trustee.

George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 26, 59 (2004) ("What has followed is the rise of debtor-in-possession financing, [and] carve-outs from that financing to pay professional fees[,] including those of the debtor and committee's counsel . . ."); see also Michael St. James, *Why Bad Things Happen in Large Chapter 11 Cases: Some Thoughts About Courting Failure*, 7 TRANSACTIONS: TENN. J. BUS. L. 169, 188–90 (2005).

In order to satisfy the powerful secured creditors and obtain the carve-outs that were essential if they were to be paid in many cases, the professionals developed debtor-in-possession . . . financing techniques that ensured that the secured creditors could 'drive the bus' and control the reorganization to maximize their benefit. . . . Often, the debtor has little negotiating leverage with the secured creditor on cash collateral, and in many cases can be expected to 'take a dive' to accommodate the secured creditor's demands.

St. James, *supra*; Todd J. Zywicki, *Is Forum Shopping Corrupting America's Bankruptcy Courts?*, 94 GEO. L.J. 1141, 1173–74 (2006). For a quick but accurate version of how estate-paid compensation works in Chapter 11, see Professor Stephen Lubben's description:

Under the Bankruptcy Code, section 327(a), when read with section 1107(a), allows a chapter 11 debtor to retain "one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons." Thus, a professional must satisfy a two-part test before retention: the professional must be disinterested and hold no adverse interest. This *ex ante* control over professionals is coupled with the bankruptcy court's power to alter professional compensation at the conclusion of a case. For example, section 328(c) gives the courts the power to deny compensation for services previously rendered by professionals, or to order disgorgement of fees already paid, if a professional is found to have been not disinterested (i.e., found to have been "interested").

It is one of the odder facets of corporate bankruptcy that a large corporation, upon entering bankruptcy, is subject to government oversight of its business choices. Under statute, the United States Trustee, "shall supervise the administration" of chapter 11 cases, "whenever the United States trustee considers it to be appropriate." The key role of the United States Trustee in chapter 11 is that of professional fee monitor—thus, even though the 1978 Bankruptcy Code is often said to have moved to a market driven system of professional compensation, a non-market actor plays a key role in the compensation of bankruptcy professionals.

mechanism to ensure that the fees stay reasonable.<sup>5</sup> We all talk about the fact that the reasonableness of fees can be a problem, especially in the larger Chapter 11 cases, but we never do anything about it.

The bankruptcy court has oversight of the payment of professional fees, but the review of those fees can be incredibly time-consuming and is highly detail-driven. Those professionals who submit their bills for court review represent real clients, but those real clients aren't writing the ultimate checks.<sup>6</sup> In most non-bankruptcy settings, there's a metaphorical moment when the professional pushes a bill across the table to the client and waits for the client to react. If the client questions a bill, the professional may well end up lowering it.

When it comes to estate-paid Chapter 11 fees, the professionals are pushing their bills across the table, but on the other side of the table, the client charged with evaluating the reasonableness of the bill may have no meaningful way to put the bill into context. Moreover, because no single client is charged with footing the professionals' entire bill, it's possible that none of the clients really cares how much these professionals are charging.<sup>7</sup> In essence, the client sitting at the table is a stand-in for entities with little voice (and little individual stake) in determining how the professional makes his billable decisions.<sup>8</sup> And sitting at another table, far away, is the bankruptcy court.<sup>9</sup>

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Since 2000, the primary empirical studies of professional fees in chapter 11 are those done by three legal academics, Robert Lawless, Lynn LoPucki, and myself. Professor Lawless has conducted the only prior study of professional fees in small business bankruptcy cases.

Lubben, *supra* note 3, at 81–82 (footnotes omitted). For a discussion of some tricky issues of administrative priorities of debtors' attorneys' fees, see Michelle Arnopol Cecil, *A Reappraisal of Attorneys' Fees in Bankruptcy*, 98 KY. L.J. 67 (2009).

5. At least when it comes to attorneys' fees, those fees are supposed to be reasonable. See, e.g., MODEL RULES OF PROF'L CONDUCT R. 1.5(a) (2009) ("A lawyer's fee shall be reasonable.").

6. Basically, those clients are "writing checks their bodies can't cash." TOP GUN (Paramount Pictures 1986) (memorable quotes available at <http://www.imdb.com/title/tt0092099/quotes>) ("Maverick, you just did an incredibly brave thing. What you should have done was land your plane! You don't own that plane[:] the tax[]payers do! Son, your ego is writing checks your body can't cash.").

7. It's possible that the dynamic of minimal scrutiny and feedback differs depending on whether the case is a liquidating Chapter 11 or a "true" reorganization case, and that the DIP's management in the latter type of case reviews the bill in the same way that a business client outside of bankruptcy would review it. For example, if—in a real reorganization—management will get bonuses paid after EBITDA (earnings before interest, taxes, depreciation, and amortization), management may well have an incentive to take a red pen to the professionals' bills.

8. I'm not the first person to make this observation. Professor Cynthia Baker has written a marvelous article about this issue. Cynthia A. Baker, *Fixing What's Broken: A Proposal for Reform of the Compensation System in Bankruptcy*, 5 J. BANKR. L. & PRAC. 435 (1996).

9. Professor Zywicki has observed that:

The massiveness of the overall fee requests, the overwhelming pages of information unrelated to fees, and the need for sophisticated, highly technical analysis makes it almost impossible for courts to exercise any coherent supervision over the content of fee requests. Nor do the other parties in the case have an incentive to object to excessive fees—the professionals employed by the creditors' committee are paid from the estate as well, thus they will have little incentive to object to excessive

Make no mistake about it—bankruptcy work, at least for Chapter 11 cases, can be lucrative. Many of the best-regarded law firms have bankruptcy groups, and those groups have a national practice.<sup>10</sup> These groups have talented lawyers, used to doing their very best for their clients (and getting rewarded for that work). But there's significant overstaffing and duplication of effort—especially in the larger bankruptcy cases. What's worse is that there's no easy way to pinpoint just where the overstaffing is occurring in each case<sup>11</sup> and no easy way to tell when the duplication of effort is necessary to represent the clients' interests and when it's just simple “me, too” make-work.

In this essay, I'll address some of the problems with evaluating professional fees in Chapter 11 cases, including the difficulties inherent in representing fiduciaries in bankruptcy cases, the skewed incentives that can tempt professionals to choose a quick sale of assets over a real chance of reorganization, and the Lake Wobegon effect<sup>12</sup> that can tempt clients to pay too much for professionals.

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fees for unnecessary work for fear that the tables may turn when the time comes for their own fee requests.

Zywicki, *supra* note 4, at 1176 (footnotes omitted).

Bankruptcy courts do try—and try hard—to monitor fees well. As the bankruptcy court in *Consolidated Bancshares* explained: “[T]his Court has a special responsibility to the creditors of bankruptcy estates when reviewing fee applications. Obviously, each dollar awarded to the attorneys and accountants is one less dollar available for payment to creditors and shareholders.” *In re Consol. Bancshares, Inc.*, 49 B.R. 467, 477 (Bankr. N.D. Tex. 1985), *aff'd in part, remanded in part on other grounds*, 785 F.2d 1249 (5th Cir. 1986).

10. See Zywicki, *supra* note 4, at 1174.

Indeed, there is a relatively small group of elite law firms, headed by Weil Gotshal and Skadden Arps, that have the resources and experience to handle large, complicated Chapter 11 cases with a national (or even international) reach. As a result, these firms can exert a tremendous amount of leverage over the choice of venue by a troubled firm, especially in the bewildering and frantic days that precede a Chapter 11 filing. . . . Regardless of where they are filed, big cases usually draw in professionals from all over the country who bill at different rates, with New York-based attorneys and professionals typically billing market rates that exceed the rates prevailing elsewhere in the country.

*Id.* (footnotes omitted); see also Kuney, *supra* note 4, at 45 (“[The Bankruptcy Code] liberalized the standards for professional compensation, thus drawing in the blue chip lawyers and law firms that had, in earlier times, created the equity receivership—the original method of federal reorganization to reorganize the railroads.”).

11. I originally called this article *The Pornography of Overstaffing*, referring to Justice Powell's famous quote about knowing pornography when he sees it. *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart J., concurring) (“[P]erhaps I could never succeed in [defining pornography] intelligibly . . . . But I know it when I see it . . . .”). The problem with overstaffing, like Justice Stewart's problem with defining pornography, is that, often, we just have a nagging feeling that something's wrong with the bill, but we can't point to line entries that justify that feeling.

12. See Dirk Johnson, *With Singing, Satire and Sentiment, Lake Wobegon Fades*, N.Y. TIMES, June 14, 1987, at 26 (referencing public radio host Garrison Keillor's fictional hometown of Lake Wobegon, where “all the women are strong, all the men are good looking and all the children are above average”); see also Rachel M. Hayes & Scott Schaefer, *CEO Pay and the Lake Wobegon Effect*, 94 J. FIN. ECON. 280, 280 (2009) (noting that just as in Keillor's mythical Lake Wobegon, “no firm wants to admit to having a CEO who is below average,” so each firm sets its CEO's pay package “at or above the median pay level”).

I. OVER-REPRESENTING FIDUCIARIES

Representing a debtor-in-possession (the DIP) or an official committee is serious, intensive work. Doing a good job means focusing on the big picture while sweating the small stuff, and the representation—like the representation of any fiduciary,<sup>13</sup> even outside of bankruptcy—can often mean eschewing the advice of the people “heading” the client in order to represent the “client” as a whole. For example, the DIP’s management may want to head in a direction that saves their jobs, even though replacing some of those managers may make more sense for the DIP’s estate. Or some of the members of the unsecured creditors’ committee may harbor a vendetta against the debtor, pushing for legal actions that make them feel better but cost too much—with too little result for the unsecured creditors who are the committee’s constituency.

Good professionals work very hard, putting in long hours over weeks or months (or even years).<sup>14</sup> And yet there’s a forest-trees problem: people can see the magnitude of estate-paid professionals’ bills, and they suspect that the professionals just might be doing good work on each of the trees while they’re missing how much the forest as a whole costs to maintain. It’s not that the professionals are necessarily churning the fees, although when I review fees in my role as a court-appointed fee expert, I wonder how many attorneys it really does take to draft a motion for stay relief or attend a hearing in which they don’t plan to have a speaking role.<sup>15</sup> My

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13. And those whose professionals are paid from estate funds are fiduciaries: the DIP is a fiduciary of the estate (whatever that means, see, e.g., C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP’s Attorney Become the Ultimate Creditors’ Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47 (1997)), and the members of a court-appointed committee are fiduciaries for their committee constituencies. See, e.g., Michael P. Richman & Jonathan E. Aberman, *Creditors’ Committees Under the Microscope*, AM. BANKR. INST. J., Sept. 2007, at 22, 22 (reminding us that creditor committee members can’t indulge in self-dealing, because they’re fiduciaries for the entire class of members represented by that committee).

14. Andy Winchell has posted a defense of the high fees of bankruptcy professionals on his blog:

It is important to understand at the outset the challenges facing bankruptcy attorneys. The practice requires an immense skill set. Not only must they know bankruptcy law inside out and backwards, they often must have both litigation and transactional skills.

. . . I would liken the motivation of a high-end bankruptcy lawyer to that of an oncologist. Both sorts of professionals absolutely intend to make a good living from their work. But there are plenty of other specialties in law and medicine in which to do that. . . .

To continue with the analogy, we do not begrudge the oncologist who is better compensated than a general practitioner. We also do not wonder whether a cancer patient might be just as well off having a less expensive treatment than the one prescribed by the leading oncologist. We do not suggest that the oncologist take a fee cut simply because the first line of treatment was successful. And of course there are not many articles questioning whether oncologists are “parasitic” even though they make their livelihood as a result of other people’s substantial misfortune.

In Defense of Bankruptcy Attorneys[’] Fees, <http://bklawblog.blogspot.com/2009/06/in-defense-of-bankruptcy-attorneys-fees.html> (June 3, 2009, 08:24 EST).

15. Cf., e.g., *In re Fleming Cos.*, 304 B.R. 85, 90–91 (Bankr. D. Del. 2003) (reducing fees because attorneys for the debtor who attended the hearings couldn’t establish that each attorney’s presence at the hearing contributed a material benefit to the estate); *In re Ray*, 283 B.R. 70, 83–84 (Bankr. N.D. Okla. 2002) (reducing fees for interoffice conferences where there were “matching entries” for multiple counsel because those entries

educated guess is that virtually all of the professionals are billing their time in good faith,<sup>16</sup> but that many of them don't spend a lot of effort trying to effect economies of scale. Moreover, the nature of a high-level Chapter 11 practice,<sup>17</sup> combined with the need to ensure that their decisions are protecting their client's constituencies (and not just the representatives of those constituencies), can cause smart people to justify to themselves the need to overlawyer or overadvise a case.<sup>18</sup> After all, if a lawyer is representing a fiduciary of a group of constituents, and if that lawyer is the fiduciary's fiduciary,<sup>19</sup> then that lawyer has some legitimate worries about "dropping

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represented duplicative efforts); *In re Jefsaba, Inc.*, 172 B.R. 786 (Bankr. E.D. Pa. 1994) (reviewing fees for duplicative work).

I haven't studied the fees in the Lehman Brothers bankruptcy closely, but a friend of mine forwarded an article noting that Weil Gotshal was billing the estate an average of \$300,000 per day. See Zach Lowe, *Put It on My (Quite Enormous) Tab: Lehman Brothers Bill Stands at \$641.9M and Counting*, AM. LAW., Mar. 25, 2010, <http://www.law.com/> (search the "Law.com Network" for "Zach Lowe Lehman Brothers"). And Lehman Brothers isn't the only case for which the fees are raising eyebrows. See, e.g., Brian Baxter, *Big Bankruptcies' Big Fees Raising Questions*, AM. LAW., Mar. 5, 2010, <http://www.law.com/jsp/article.jsp?id=1202445579020>; see also Michael Oneal, *Fees Flourish in Bankruptcy*, CHI. TRIB., Mar. 28, 2010, available at [http://articles.chicagotribune.com/2010-03-28/business/ct-biz-0328-fees--20100328\\_1\\_fees-debtors-firms-and-other-professionals](http://articles.chicagotribune.com/2010-03-28/business/ct-biz-0328-fees--20100328_1_fees-debtors-firms-and-other-professionals); Reorganized ASARCO LLC's Response and Objection to Baker Botts L.L.P.'s Final Fee Application, *In re ASARCO LLC*, No. 05-21207 (Bankr. S.D. Tex. Mar. 10, 2010) (reorganized debtor objecting to final fee application of law firm for, among other things, charging the work of summer associates to the estate).

And unreasonable staffing decisions aren't just the province of large bankruptcy cases. My friend Chip Bowles pointed out a case in California involving a trust in which the former trustee's lawyers used "[e]ight attorneys from three major law firms . . . with four to five of those attorneys simultaneously appearing at the 14-day court trial." *Donahue v. Donahue*, 105 Cal. Rptr. 3d 723, 725 (Cal. Ct. App. 2010); see also CHARLES DICKENS, *BLEAK HOUSE* (1884) (Jarndyce v. Jarndyce lawsuit's legal fees overwhelm the case).

16. Cf. Martha Neil, *Greenberg Traurig Partner Charged with Overbilling Client by \$1M to Gain Prestige in Firm*, ABA J., Mar. 5, 2010, [http://www.abajournal.com/news/article/greenberg\\_traurig\\_partner\\_charged\\_with\\_overbilling\\_client\\_by\\_1m\\_to\\_gain\\_pre/](http://www.abajournal.com/news/article/greenberg_traurig_partner_charged_with_overbilling_client_by_1m_to_gain_pre/) (non-bankruptcy case).

17. See Kuney, *supra* note 4, at 27 ("It is not necessary for this process to require express collusion on the part of the different parties; it can simply result from the agency problems attendant upon any incorporated entity that must act through agents and from the market's 'invisible hand' guiding the various players." (footnote omitted)).

18. For a discussion of how easy it is for smart people to fool themselves, see, e.g., Nancy B. Rapoport, *The Curious Incident of the Law Firm That Did Nothing in the Night-Time*, 10 LEGAL ETHICS 98 (2007) [hereinafter *The Curious Incident*] (reviewing MILTON C. REGAN, JR., *EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER* (2004)).

19. Although the majority rule is that these lawyers are the fiduciary's fiduciary, not everyone agrees. Compare C.R. "Chip" Bowles, Jr. & Nancy B. Rapoport, *Debtor Counsel's Fiduciary Duty: Is There a Duty to Rat in Chapter 11?*, AM. BANKR. INST. J., Feb. 2010, at 16, 64–65 (explaining that when the DIP either doesn't understand or doesn't perform its fiduciary duties, the DIP's counsel must act as fiduciary), and Bowles & Rapoport, *supra* note 13, at 71–72 (discussing counsel's fiduciary duties in the chapter 11 context), with Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 457–61 (D. Utah 1998) (rejecting the notion that DIP's counsel is a fiduciary of the estate and its beneficiaries because the Bankruptcy Code does not explicitly mandate such an idea and because imposing a fiduciary duty "conflicts with counsel's ethical responsibilities to the client"), and *In re Sidco, Inc.*, 173 B.R. 194, 196 (E.D. Cal. 1994) (affirming the bankruptcy court's conclusion that "attorneys for debtors-in-possession have a fiduciary duty to their client, the debtor-in-possession, not to the creditors and shareholders whose interests may be adverse to the debtor"), and Susan M. Freeman, *Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What Is a Fiduciary, Anyway?*, 17 AM. BANKR. INST. L. REV. 291, 292 (2009) (arguing that counsel's fiduciary duty to its client and the

the ball” in that fiduciary’s representation. As Professor Cynthia Baker has observed, “[c]ommittee members might direct professionals to monitor every aspect of a case, even actions with a negligible impact on distributions, to avoid claims that members breached their fiduciary duties.”<sup>20</sup> In essence, the fiduciaries might be practicing the equivalent of “defensive medicine” in an effort to fulfill their fiduciary duties.<sup>21</sup>

#### A. A “Conspiracy of Silence”?

Professors Robert Rasmussen and Randall Thomas have pointed out that professional fees in Chapter 11 cases present a classic “agency problem.”<sup>22</sup> Typically, estate funds for paying court-appointed professionals come out of the distribution otherwise available to unsecured creditors.<sup>23</sup> Thus, because the unsecured creditors are the ones who bear the costs of the activities that estate-paid lawyers and other professionals undertake, and because the unsecured creditors typically act through the representatives of the creditors’ committee, there’s a disconnect between the clients sitting across from the table (the members of the committee) and the full panoply of constituents whom the committee represents.<sup>24</sup>

Professor Bob Lawless has described the perception that there’s no easy check on professional fees. In a 1994 study, he and his colleagues adverted to the popular hypothesis of a “conspiracy of silence” among professionals—at least those in large Chapter 11 cases.<sup>25</sup> A rather more vivid description (from the same study) captures

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Committee, along with other laws, regulations, and rules, obviate the need to impose on DIP counsel a fiduciary duty for the estate). See also *In re Count Liberty, LLC*, 370 B.R. 259, 279–83 (Bankr. C.D. Cal. 2007) (discussing the majority and minority views).

20. Baker, *supra* note 8, at 449.

21. Defensive fiduciary-ing?

22. Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1369 (2000) (“Under the Bankruptcy Code, the debtor’s attorneys are paid from the firm’s assets, ahead of all prepetition, unsecured creditors. This payment scheme creates an agency problem—the managers hire the attorneys, but then have little incentive to monitor the amount of fees paid by the estate. Instead, the group that pays these fees is the debtor’s unsecured creditors.” (footnotes omitted)).

Of course, when a bankruptcy estate is seriously underwater, there’s no money left for unsecured creditors at all, and the secured creditors are the ones footing the bills of the professionals. In such a situation, perhaps the secured creditors are paying a great deal of attention to the professionals’ bills. It’s also possible that such scrutiny comes from the secured creditors pressing the DIP’s management to, in turn, push back on the professionals’ bills.

23. Lynn LoPucki teases out the concept of who are really the residual owners (that class that ends up paying for court-appointed professionals) in *The Myth of the Residual Owner: An Empirical Study*. Lynn M. LoPucki, *The Myth of the Residual Owner: An Empirical Study*, 82 WASH. U. L.Q. 1341 (2004).

24. I know: class-action plaintiffs face the same issue—the named plaintiffs in the class act for the class as a whole. And the problems with the metaphorical “pushing the bill across the table” are similar. The main difference is that in a Chapter 11 bankruptcy case, the plaintiffs are also paying for the defendant’s professionals (i.e., the DIP’s professionals).

25. Here’s the context of that quote:

Some evidence existed that professional fees in small business bankruptcies are escalating. Yet, professional fees did not have statistically significant relationships with intuitive determinants of



the visceral reaction to high professional fees in Chapter 11: “Why does bankruptcy cost so much? Certainly a popular answer is that bankruptcy professionals are feeding at the trough, gorging themselves at the expense of a bankruptcy system that has neither the ability nor inclination to control them.”<sup>26</sup>

And it’s not just academics who have used the “trough-feeding” analogy. In a recent case, a bankruptcy court adamantly rejected two retention applications by financial advisors, referring to them as “hogs,” once in the original opinion rejecting their employment applications, and once in the opinion on the motion for reconsideration.<sup>27</sup> The media have also hit hard on the fee issue, time and time

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bankruptcy costs, such as length of time in bankruptcy and the number of creditors in the proceeding, that might explain this tendency toward growth. Other factors appear to be determining the amount of professional fees in these bankruptcies.

What these other factors are, however, is unclear. We did find some evidence that chapter 11 professional fees increased when the concentration of secured creditors in the case increased. The presence of many secured creditors should increase the complexity of the bankruptcy case, although we did not find such a relationship in our chapter 7 cases. One possible answer is the popular one: bankruptcy professionals control the level of their own fees through a “conspiracy of silence.” No bankruptcy professional will dare question the fee of another lest the inquirer suffer the same fate. . . . For the most part, however, these beliefs rest on anecdotes from large business bankruptcies.

Robert M. Lawless et al., *A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies*, 1994 U. ILL. L. REV. 847, 877 (footnote omitted); *id.* at 850 (“Our perception of bankruptcy costs has been drawn from large bankruptcies. The popular press has portrayed large business bankruptcies as a system out of control, a money mill operated primarily for the benefit of the attorneys, accountants, and other professionals who receive fees from the bankruptcy courts.”); *see also* Kuney, *supra* note 4, at 111–12 (“The law of unintended consequences has thus led to a reshuffling of the players that made up the so-called ‘bankruptcy rings’ of the past and encouraged the development of a circle of creditor interests and professionals that is wider, deeper, and more sophisticated than any of the old rings.” (footnotes omitted)). It’s certainly true that, since I’ve left practice, investment bankers and hedge funds have taken larger roles in more Chapter 11 bankruptcies.

26. Lawless et al., *supra* note 25, at 871. My guess is that bankruptcy judges do want to keep fees down—see, e.g., cases discussed *supra* note 15—but without the staffing to comb through all of the bills (or active objections to bills), there’s only so much that the judges can do by themselves.

27. *In re Energy Partners, Ltd.*, 409 B.R. 211, 237 (Bankr. S.D. Tex. 2009) (“These two investment banking firms have become hogs.”). The *Energy Partners* court went on to observe that:

In these dire financial times, a request to be paid a \$25,000.00 per day witness fee out of the coffers of a publicly traded company in bankruptcy is not only excessive, but unconscionable—particularly when the amount of this *daily* fee is compared to the *annual* compensation earned by certain Americans who provide arguably more essential services to society.

*Id.* at 231 & n.16. On reconsideration, the court reiterated its position:

One of these investment banking firms, Houlihan Lokey Howard & Zukin Capital, Inc. (Houlihan Lokey), and the Official Committee of Unsecured Noteholders (the Committee) which sought to employ it, have now filed a joint motion to amend the Opinion. They are unhappy because, among other things, the Opinion referred to the investment bankers as greedy, arrogant hogs. Their motion to amend requests this Court to unsay what it said and to unwrite what it wrote. This, the Court will not do.

*In re Energy Partners, Ltd.*, No. 09-32957-H4-11, 2009 WL 2970393, at \*1 (Bankr. S.D. Tex. Sept. 15, 2009) (footnote omitted); *see also id.* at \*1 n.1 (“Given that the Fifth Circuit itself has used the word ‘hog’ to characterize the principle of ‘too much,’ this Court believes that it is entirely appropriate to use the word ‘hog’ in reference to Houlihan Lokey.”).

again.<sup>28</sup> In an attempt to parse the magnitude of the problem, Professor Lynn LoPucki and several of his co-authors have studied the relationship of the choice of forum for large bankruptcy cases to the magnitude of professional fees.<sup>29</sup> In the next section, I'll discuss some of those findings, as well as some criticisms of the studies.

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28. Daniel Gross, *The Bankruptcy Parasites: GM's Chapter 11 Filing Will Be Bad News for Everyone—Except the Lawyers, Accountants, and Paper-Pushers Who'll Make a Mint Off It*, NEWSWEEK, May 29, 2009, <http://www.newsweek.com/id/199997>.

[N]ot all bankruptcies are efficient, short, and sweet. When the proceedings are contentious, or if there's a lot of financial and industrial spaghetti to be untangled, the proceedings can go on for many months, even years, in which case the system grows somewhat less efficient. The creditors and debtors are joined by a third set of wily players—the suits, lawyers, accountants, and financing wizards required to fix, defend, wind down, and restructure a failed company.

Most of these people, of course, bill by the hour. And thanks to the transparency of our legal system, we know precisely how much they bill. Each quarter, law firms, turnaround consultants, and accountants apply to the bankruptcy court, detailing the services they rendered and precisely how much they cost. Creditors can raise objections to the fees—after all, every penny a law firm gets is one less available for bondholders. But they usually don't object too strenuously. And the firms don't offer discounts to companies just because they are bankrupt.

....

In the early 1990s, when I covered bankruptcy courts, I enjoyed scouring through the applications for bankruptcy fees. The best were those produced by the most anal-retentive of the professionals, the accountants. They meticulously counted the precise number of minutes each worked on the matter—and then calculated the precise number of minutes it took them to count the precise number of minutes each professional worked on the matter. I remember a line item, more than \$10,000, that was the bill for preparing the bill.

*Id.*; see also Theodore Eisenberg, *Differing Perceptions of Attorney Fees in Bankruptcy Cases*, 72 WASH. U. L.Q. 979, 980 (1994).

Perceptions of high attorney fees are at the heart of the concern about the bankruptcy system. Chapter 11 cases are viewed as triggering a fee frenzy. In the public's mind, lawyers submit bills for large fees, are rarely rebuffed by the courts or other interested parties, and generate huge fees over the many years during which a Chapter 11 case might be pending. Newspapers heighten these perceptions by often reporting about high fees.

Eisenberg, *supra* (footnotes omitted); Posting of Carolyn Elefant to Legal Blog Watch, [http://legalblogwatch.typepad.com/legal\\_blog\\_watch/2009/05/bankruptcy-lawyers-parasitic-or-productive.html](http://legalblogwatch.typepad.com/legal_blog_watch/2009/05/bankruptcy-lawyers-parasitic-or-productive.html) (May 29, 2009, 16:13 EST).

[A]s bankruptcies grow increasingly complex and impact a wider number of interests, such as bondholders and investors (who, in many instances, managed portfolio money for ordinary people), should law firms and other professional service providers be entitled to be paid their full rates, while other creditors sacrifice? Or do law firms provide a valuable enough service that they deserve the fees they charge in these matters?

Elefant, *supra*.

29. Among their newest empirical works regarding this issue is Lynn M. LoPucki & Joseph W. Doherty, *Professional Overcharging in Large Bankruptcy Reorganization Cases*, 5 J. EMPIRICAL LEGAL STUD. 983 (2008). One of their observations in this article is particularly apt: "It follows that for a given amount involved in litigation there is a fee amount below which billing pressures operate and above which they do not." *Id.* at 1001. Moreover, LoPucki and Doherty posit that "professionals have the *opportunity* to bill more in bigger cases, longer cases, and cases involving more professional firms. . . . Those billing opportunities, not merely the value of the services required, drive fees and expenses." *Id.* at 1011.

*B. The Effect of Forum Choice on Fees—As Best We Can Tell*

Professor LoPucki and his colleagues have not shied away from criticizing what they perceive as a corrupt system in which bankruptcy courts compete for the juiciest cases by relaxing Bankruptcy Code standards for, among other things, conflicts of interest and payment of professional fees. In one book and several articles, Professor LoPucki has alleged that some bankruptcy courts are competing for the largest cases by allowing certain fee-approval practices that he considers to be illegal.<sup>30</sup> That allegation has won him few friends. The allegation has also triggered numerous critiques of his methodology and conclusions.<sup>31</sup>

This essay is not the place to perform a complete review of Professor LoPucki's assertions.<sup>32</sup> For the purposes of this essay, I'll focus on his charge that bankruptcy courts have lost control over professional fees.<sup>33</sup>

We can agree on some basic facts. Lawyers charge more, on average, for Chapter 11 cases<sup>34</sup> than they do for Chapter 7 or Chapter 13 cases.<sup>35</sup> Fees on the coasts (East or West<sup>36</sup>) are higher, on average, than they are in the middle of the country.<sup>37</sup> Even

30. See, e.g., LOPUCKI, *supra* note 3; *Routine Illegality*, *supra* note 3; *Rise of the Financial Advisors*, *supra* note 3; Lynn M. LoPucki, *Where Do You Get Off? A Reply to Courting Failure's Critics*, 54 BUFF. L. REV. 511 (2006) [hereinafter *Where Do You Get Off?*].

31. I'm not an empiricist, although I like hanging out with empiricists. I'll leave it to the reader to review the empirical critiques in detail. See, e.g., Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425 (2006) (reviewing LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2006)); Marcus Cole, *"Delaware Is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845 (2002); A. Mechele Dickerson, *Words That Wound: Defining, Discussing, and Defeating Bankruptcy "Corruption"*, 54 BUFF. L. REV. 365 (2006); Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?*, 54 BUFF. L. REV. 401 (2006); Rasmussen & Thomas, *supra* note 22; Charles J. Tabb, *Courting Controversy*, 54 BUFF. L. REV. 467 (2006); Zywicki, *supra* note 4.

32. Professor Melissa Jacoby summarizes most of those allegations nicely:

This is LoPucki's list of damaging changes to court practices:

1. The courts lost control over professional fees.
2. Failed managers tightened their grips on their jobs and companies.
3. Corporate debtors had more difficulty recovering money taken by failed managers.
4. Failed managers began paying themselves huge retention bonuses.
5. The courts began rubber[-]stamping prepackaged plans.
6. So-called critical vendors began grabbing the shares of other unsecured creditors.
7. Managers began selling their companies at inadequate prices for personal benefit instead of reorganizing them.

Jacoby, *supra* note 31, at 416–17.

33. See *id.*

34. Their hourly rates are typically much higher than the hourly rates for consumer-side bankruptcy lawyers.

35. Eisenberg, *supra* note 28, at 994 ("The more a lawyer does work for debtors (in contrast to other actors in the bankruptcy system) the lower the fee." (footnotes omitted)). It's possible that (at least, before the recession) creditors have been willing to pay more for representation than debtors have been.

36. Not the Gulf Coast, though.

though many of the studies of fees have had relatively small sample sizes<sup>38</sup> (except for Professor Lubben's study<sup>39</sup>), there is, in fact, some consistency among the findings, and some conclusions aren't particularly controversial:

*Venue . . . is chosen by the firm's management in consultation with their attorneys. Attorneys, all else being equal, prefer jurisdictions that routinely approve fee requests as compared to those that pare back such requests. Managers prefer jurisdictions that give them an advantage in the negotiations with creditors, which are the hallmark of a traditional Chapter 11 proceeding.*<sup>40</sup>

Moreover, there have been real instances where practitioners and judges have discussed the problems with filing cases in certain jurisdictions and then resolved some of those problems. The most-cited example is the confab between the Houston bankruptcy bench and the Houston bankruptcy bar.

*Local attorneys complained that the bankruptcy judges were reticent to approve an hourly rate of above \$300 an hour. After receiving the report of the advisory committee, one of the local bankruptcy judges stated, "This is the sound bite. The war on fees is over. The bright line of \$300 is gone."*<sup>41</sup>

The bench-bar understanding isn't, in itself, that surprising. Courts and lawyers often discuss ways to improve the court system, across a variety of practice areas and a variety of jurisdictions. The question is whether such "improvements" are done for benign reasons or for more self-interested ones.

Professor LoPucki alleges corruption:

*Because I have no way of knowing whether any particular judge made any particular ruling in bad faith, Courting Failure makes no charge of corruption against any particular judge or court. But were it possible to know that a particular judge made a particular ruling with the motive of*

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37. See, e.g., Eisenberg, *supra* note 28, at 991–92 (presenting a table showing average hourly compensation for partners in Chapter 11 cases and reporting higher averages in states on either coast than the hourly rates in states in the middle of the country).

38. Lubben, *supra* note 3, at 78–79 ("Although these papers have made some progress in informing intellectual debates about chapter 11, they all suffer from a two-part problem: they rely on small sample sizes and capture but an isolated part of the chapter 11 market.").

39. *Id.* at 79 ("[The Lubben study] database includes approximately 1,050 chapter 11 cases filed in 2004—almost more than 1,000 more cases than the next largest American study.").

40. Rasmussen & Thomas, *supra* note 22, at 1392 (footnotes omitted); see also Cole, *supra* note 31, at 1866 ("While all of the lawyers queried adamantly reject the assertion that the Delaware judges fail to scrutinize fee applications, they are divided about the role that attorneys' fees play in the venue-selection decision process.").

41. Rasmussen & Thomas, *supra* note 22, at 1369.

*attracting future cases, and that the judge would have ruled differently in the absence of that motive, “corruption” does not seem to me to be too strong a word. Because they take from one constituency and give to another for the benefit of the judge or the judge’s supporters, such rulings are, in my opinion, “rotten or morally depraved.”*<sup>42</sup>

Because correlation does not imply causation,<sup>43</sup> ascribing a nefarious motive to the courts in which more big-time Chapter 11 cases get filed is a risky proposition. And not everyone agrees with Professor LoPucki’s conclusions about corruption. For example, in Professor Marcus Cole’s analysis of the forum-shopping issue, some bankruptcy lawyers pooh-poohed the notion that fees drove the choice of forum.<sup>44</sup> Professor Todd Zywicki has noted the correlation between forum choice and professional-friendly courts, but he has declined to paint professional-friendly courts as places that pervert the language and purposes of the Bankruptcy Code.<sup>45</sup>

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42. *Where Do You Get Off?*, *supra* note 30, at 517–18. Professor LoPucki continues his serious allegations in a more recent study of how fees are paid in Chapter 11 cases:

This Article reports the results of an empirical study showing that the United States bankruptcy courts routinely authorize and tolerate professional fee practices that violate the Bankruptcy Code and Rules. The practices are concentrated in the largest, most visible bankruptcy cases—cases like Lehman Brothers, World[C]om, Kmart, and US Airways. The practices are promoted and taken advantage of by attorneys, investment bankers, accountants, consultants, and other professionals. Some of the firms involved are among the largest and most prestigious in the world. They include Skadden Arps, Weil Gotshal, Kirkland and Ellis, Jones Day, Fried Frank, Blackstone, Houlihan Lokey, and many others.

*Routine Illegality*, *supra* note 3, at 423.

43. See, e.g., John Aldrich, *Correlations Genuine and Spurious in Pearson and Yule*, 10 STAT. SCI. 364, 365 (1995) (summarizing Karl Pearson, developer of the theory of correlation in statistical analysis, as thinking that “causation is correlation . . . *except* when the correlation is spurious, when correlation is not causation”). One parody states: “Correlation does not imply causation, but it does waggle its eyebrows suggestively and gesture furtively while mouthing ‘look over there[.]’”. Correlation, *xkcd: A Webcomic of Romance, Sarcasm, Math and Language*, <http://xkcd.com/552/> (last visited Apr. 17, 2010) (statement appears as rollover text).

44. See Cole, *supra* note 31, at 1866–67.

45. Zywicki, *supra* note 4, at 1173–74.

In theory, a debtor may thus be forced into the choice between its preferred counsel and preferred forum; in practice, the debtor is unlikely to have an independent preference for any given venue and the debtor’s preference is shaped by the lawyers’ advice. In all likelihood, the bankrupt company will have a stronger preference for a particular law firm to handle the case than for a particular court. There also seems to be some correlation between those courts that are deferential to professional fees, on one hand, and those that also tend to be relatively “pro-debtor” on the other. LoPucki suggests that Delaware is an example of such a forum. Thus, the venue preferences of the debtor’s management and attorneys will usually amplify rather than contradict each other. This correlation of mindset may not be coincidence, as the overriding mindset of such courts may be to treat bankruptcy proceedings as primarily multi-party private actions and to permit the parties to work out matters privately through negotiation. This mindset may lead these same courts to take a relatively hands-off approach to matters of fees and conflicts of interest.

*Id.*

And Professor Charles Tabb's point-by-point analysis of LoPucki's allegations of judicial corruption is elegant in its levelheadedness.<sup>46</sup>

Others who have studied different sets of data have come to rather less dramatic conclusions: attorneys' fees take up the lion's share of costs in bankruptcy<sup>47</sup> (although the bigger the bankruptcy estate, "professional fees as a percentage of the estate's value tend to decline");<sup>48</sup> and the longer a debtor is in Chapter 11, the higher the costs.<sup>49</sup> Still others suggest that forum-shopping can be based in common-sense and be efficient.<sup>50</sup>

And the broadest study of fees in Chapter 11, by Professor Stephen Lubben, comes to significantly more nuanced conclusions by putting the fees in a broader perspective:

*Corporations [outside of bankruptcy] spend a lot of money making changes to their financial structure. When undertaking an IPO, a company faces a host of professional fees, including attorney, accountant, investment banker, underwriter, and other adviser fees. The underwriter fee typically equals 7 percent of the offering. The fees paid to lawyers, accountants, and other advisers can be an additional 3 percent or more.*

....

*In this context, chapter 11 expenses totaling about 4.5 percent of a debtor's assets plus debts seem unexceptional.*

....

*Of course, chapter 11 commonly occurs in a context of financial hardship for creditors and employees of the bankrupt firm. In this setting, the image*

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46. Tabb, *supra* note 31, at 488–89.

47. Stephen P. Ferris & Robert M. Lawless, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. PITT. L. REV. 629, 653 (2000).

48. Robert M. Lawless et al., *A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies*, 1994 U. ILL. L. REV. 847, 851. There has been, though, an increase in the use of financial advisors. See *Rise of the Financial Advisors*, *supra* note 3, at 162–63 ("This trend toward greater use of financial advisors in chapter 11 cases of large public companies appears to have existed for a long time.").

49. Ferris & Lawless, *supra* note 47, at 657 (noting a positive relationship between the duration of time spent in reorganization and bankruptcy costs).

50. Rasmussen & Thomas, *supra* note 22, at 1407 (arguing that "available venues for bankruptcy, rather than being contracted, should be expanded" but that managers should preselect a forum to avoid self-interested choices by managers); see also Ayotte & Skeel, *supra* note 31, at 456–57 (suggesting that banks wouldn't let debtors file in professional-friendly courts if that meant that those courts let the debtors' bad managers continue in control); Dickerson, *supra* note 31, at 371–73 (positing that bankruptcy courts' adoption of procedures used in districts like Delaware and New York don't make them inherently corrupt, contrary to Professor LoPucki's suggestion).

*of professionals collecting more than \$134 million in professional fees is understandably jarring for many . . .*<sup>51</sup>

Let's assume, at least for the sake of argument, that some courts have mixed motives for making professional-friendly changes to the ways that fees are reviewed and approved, and that the changes have fostered forum-shopping in a way that privileges professionals to the disadvantage of their clients.<sup>52</sup> Fine.<sup>53</sup> The real issue, for me, is what, if anything, we can do about the reasonableness of the professionals' bills and the review of those bills, irrespective of the motives.

*C. Do We Have a Problem with the Way That We "See" the Bills?*

The Bankruptcy Code has all sorts of checks and balances on professionals' fees. The court must approve the appointment of professionals before they can start charging the estate for their services;<sup>54</sup> there are restrictions on which professionals can be employed;<sup>55</sup> the professionals must file all sorts of notices and statements regarding their bills;<sup>56</sup> and parties in interest can object to the bills, with an opportunity to be heard.<sup>57</sup>

Part of the problem with the checks and balances is that every player has limited information about the reasons for the choices that the various professionals are making about how they represent their clients.<sup>58</sup> Even the court and the U.S. Trustee won't see the strategy sessions that professionals must have to determine how to respond to a development in the case—and certainly, none of the clients (or client representatives) has access to the other parties' strategy decisions.<sup>59</sup> Each of the strategy choices that a professional makes in the case can be justified—or

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51. Lubben, *supra* note 3, at 130–32 (footnotes omitted). Among other reasons that this particular article is so good is that Professor Lubben, who has a lovely, dry sense of humor, begins the article with a quote from that classic anti-lawyer (or, at least, anti-fee-churning) novel, *Bleak House*. *Id.* at 77.

52. Please don't quote me out of context here. I'm not saying that I agree with these assumptions. I don't.

53. For what it's worth, based on my own interactions with judges, I just don't buy those allegations. I haven't run across a single judge who has alluded, even glancingly, to such motives, and every bankruptcy judge with whom I've interacted takes his or her responsibilities seriously.

54. See 11 U.S.C. § 327 (2006).

55. See *id.* §§ 101(14), 327, 328, 1107.

56. See *id.* §§ 329, 330, 331; FED. R. BANK. P. 2014, 2016.

57. See 11 U.S.C. § 330.

58. There's a possibility that repeat players in the system—such as creditors whose lines of business often put them on creditors' committees and Chief Reorganization Officers who tend to deal with repeat-player creditors—might have an incentive to keep professionals' fees reasonable. I think that a study that takes repeat-player behavior into consideration would be mighty interesting. Certainly, though, one-time players—creditors who don't often find their debtors in bankruptcy—are less likely to be able to evaluate professionals' bills easily.

59. That's why fee studies that look at the number of creditors in a case are using that information to try to capture the geometric progression of actions taken in the case that then cause reactions, and reactions to those reactions. See generally STEPHEN J. LUBBEN, AMERICAN BANKRUPTCY INSTITUTE: CHAPTER 11 PROFESSIONAL FEE STUDY (2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1020477##](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020477##).

rationalized—as a way of best positioning the fiduciary that the professional is advising.

And I use the word “rationalized” not in a pejorative sense but because all humans rationalize their decisions, all the time.<sup>60</sup> Lawyers will rationalize sending several people to a hearing, rather than one or two, because there might be issues that one of these extra people needs to cover, and the risk of not sending the right person to the hearing is a risk of a breach-of-fiduciary-duty lawsuit later. Every estate entity in a case will want its own financial advisor, in order to check the work of every other financial advisor,<sup>61</sup> because the decision to rely on other entities’ financial advisors could also trigger a breach of fiduciary duty lawsuit. There’s a very real sense that the failure to act is more costly than the expense of acting.<sup>62</sup>

Those risk-adverse decisions add up over time. In much of the non-bankruptcy world, a client might review a bill with a first-year (or mid-level) associate checking a docket weekly for entries and have, as we say down in East Texas, a hissy fit: why would someone billing \$300/hour need to check the docket when a paralegal can do it for half the cost?<sup>63</sup> That client would pick up the phone,<sup>64</sup> call up the billing partner, and ask for a discount on that month’s bill. But when, say, someone on the unsecured creditors’ committee sees a bill where a new-ish associate has reviewed the docket and puts the report of “potentially interesting docket entries” into a memo, which every lawyer up the food chain then reads (each billing time at

60. For a much longer discussion of how humans rationalize, using such cognitive mistakes as cognitive dissonance, diffusion of authority errors, and social pressure errors, see, e.g., NANCY B. RAPOPORT, JEFFREY D. VAN NIEL & BALA G. DHARAN, *ENRON AND OTHER CORPORATE FIASCOS: THE CORPORATE SCANDAL READER*, 2D *passim* (2009); *The Curious Incident*, *supra* note 18.

61. One of the reasons that the court in *Energy Partners* refused to appoint Houlihan Lokey and Tudor Pickering as financial advisors was that there was already a financial advisor in the case, and that advisor, not coincidentally, was charging far less than either Houlihan Lokey or Tudor Pickering was proposing to charge. See *In re Energy Partners, Ltd.*, 409 B.R. 211, 226–27 (Bankr. S.D. Tex. 2009).

62. That hesitation reminds me of a great scene in *The Rookie*:

Dave Patterson: Jimmy, how fast were you throwing fifteen years ago?

Jimmy: Slow enough to where scouts stopped using the word “fast”.

Dave Patterson: Seriously, how fast were you throwing?

Jimmy: I don’t know . . . 85–86?

Dave Patterson: You just threw 98 miles an hour.

Jimmy: Nawww!

Dave Patterson: Twelve straight pitches, three radar guns. Same thing on all of ‘em.

Jimmy: Look, Dave, there’s no way . . .

Dave Patterson: Jimmy, I’ve been a scout for a long time, and the number one rule is, arms slow down when they get old. Now, if I call the office and tell ‘em I got a guy here almost twice these kids’ age, I’m gonna get laughed at. But, if I don’t call in a 98-mile-an-hour fastball, I’m gonna get fired! I’m just saying there’s a chance you might get a call on this.

THE ROOKIE (Buena Vista Pictures 2002) (memorable quotes available at <http://www.imdb.com/title/tt0265662/quotes>). Of course, in *The Rookie*, the decision to try out Jimmy Morris was a good call. No one laughed at that decision by the end of the movie (or in real life).

63. And certainly, when it comes to expertise, seasoned paralegals know a heck of a lot more about what to check in a docket than a newbie lawyer does.

64. Or send an email.



increasingly higher rates), and which then a paralegal spends an hour or two filing into different matters for that bankruptcy case, can that committee member really push back and say that too much work is being billed? Does that committee member know enough to make that value decision?

Conversely, when two partners draft a motion—at their much-higher rates—instead of having an associate lower down on the billing scale draft it, the committee member may be inclined to think that the partners, who can draft more quickly, will be more efficient at drafting that memo. Maybe that’s true; sometimes, it’s certainly true. For most memos, though, pushing the drafting work down to lower-billing associates (and then writing down<sup>65</sup> the excess time that the associates spent on the draft) will save the client money. That last point—writing down the excess time so that the client doesn’t have to foot the bill for waste—is something that doesn’t happen as often as it used to. In one case in which I was involved, one law firm testified at its final fee application that it never wrote down any of its time.

A bankruptcy judge reviewing the bill will often ask about such decisions as allocation of workload and writing down time, but in the larger cases, the sheer volume of the bills makes that detailed scrutiny very difficult. It’s up to the professionals in the case to decide how to staff their cases and how much to charge for these various line-items in a bill, and one of the fears that lawyers who represent fiduciaries have is that by failing to “lawyer-up” a matter and do as much work as possible, they’ll be called to task for missing something important, thereby breaching their duty to their client(s). Or they fear that they’ll be called to task for failing to file a “me, too” sort of brief, supporting some other entity’s action.

Is the risk of such a breach of duty suit real? Probably not. The lawyers likely could sit down with the DIP or creditors’ committee<sup>66</sup> and have a frank discussion about the cost-benefit issues of staffing certain matters and about pursuing certain avenues, and then the lawyers could let the DIP or creditors’ committee decide if the expense is worthwhile. If a court-appointed fee expert is involved in the case, there’s nothing stopping the professionals from contacting that expert to talk about potential actions ahead of time in order to get the expert’s take on the reasonableness of such actions.<sup>67</sup> Fiduciaries outside of bankruptcy law have to make cost-benefit decisions about what to pursue and how to pursue it. A reasonable decision that a cost isn’t worth the benefit is unlikely to trigger accusations that the professional abrogated his duty to his client.

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65. “Writing down” means to determine that the client will not have to pay for certain billable work because the billing partner has zeroed out that part of the bill. This zeroing out of wasteful billing is considered “billing judgment,” and it’s in shorter supply than it used to be.

66. And other committees appointed in the case.

67. That expert would, of course, have to keep such discussions confidential so as to avoid revealing one party’s strategy to any other party in the case, and the court order appointing such an expert should provide explicitly for a “consultation option.”

Even if the risk of a breach of fiduciary duty claim isn't high, lawyers still like being able to do everything that they can do for their clients. And if the client authorizing "everything" (or, more accurately, listening to the lawyer explain why he or she is already doing something to protect that client's interests) isn't the one who has to foot the entire bill, there's no real incentive to hold back.<sup>68</sup> "Reasonable" fees for a client who's metaphorically sitting across the table from the professional can be very different from "reasonable" fees for clients who are each only bearing a small percentage of the bills, in the case of a committee's constituency, or who aren't bearing any of it, in the case of the DIP.

Add to this issue of not "seeing" the bills accurately the human tendency to think "there but for the grace of [insert your preferred deity here] go I." That "there but for the grace" mentality contributes to a reluctance to object to fee applications on the part of lawyers whose fee applications look remarkably similar to one's own.<sup>69</sup> If one firm sends five professionals to do the job of one or two, is that firm really going to object to another firm that also tends to overstaff matters? Sometimes, sure; but often, no.

So how can a court, or the U.S. Trustee, or a court-appointed fee expert really tell if the fees being requested are reasonable?<sup>70</sup> As my colleague Chip Bowles has said, "Fee reviewing is either rocket science or kindergarten math—there's no in-between."<sup>71</sup> Either the reviewers are going to catch obvious mistakes or overcharges,<sup>72</sup> or they're going to miss those fees and expenses that reflect an excess of diligence on the professional's part.<sup>73</sup>

I remember to this day a particularly obvious error in a case in which I had been the court-appointed fee expert. One lawyer had charged the estate for a \$140 shirt. His rationale was that he'd had to stay overnight unexpectedly and needed a shirt, and that therefore the bankruptcy estate should reimburse him. Setting aside who

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68. Lynn LoPucki's latest article makes this point—a bit more aggressively than I do. *Routine Illegality*, *supra* note 3, at 424–25.

In bankruptcy, the motivations which normally prevent overcharge are often absent. It matters very little to a bankrupt whether his attorney's fee is large or small since it will be paid out of assets which in any event will normally be completely consumed in distribution. It is the claimant with a lesser priority and the general creditors who, in effect, pay excessive fees through a reduction in the value of the assets available to them.

*Id.* (quoting H.R. REP. NO. 88-99 (1963)).

69. Not only might we have a there-but-for-the-grace problem, but it's also possible that various professionals will tend to suggest the hiring of those other professionals with whom they're most comfortable.

70. Sometimes, fee issues arise when other issues, such as conflicts of interest, boil to the surface. *See, e.g.*, Roger Parloff, *Boise Firm Says: Where's the Beef?*, CNNMONEY.COM, Feb. 6, 2006, [http://money.cnn.com/2006/02/06/news/newsmakers/boies2\\_fortune/](http://money.cnn.com/2006/02/06/news/newsmakers/boies2_fortune/).

71. Interview with C.R. "Chip" Bowles, Member, Greenebaum Doll & McDonald PLLC (Feb. 16, 2010).

72. In one case, we caught an almost-\$400,000 bill for a conflicts check. That's a lot of conflicts-checking.

73. *See* Lubben, *supra* note 3, at 101 ("Fees requested are typically granted. Indeed, the most frequent explanation for a discrepancy between the fees requested and the fees granted in a case is that the court had yet to enter an order on the fee application.").

should own that shirt—if the estate was paying for it, shouldn't the estate get the shirt?—the expense was miniscule when compared to the total fees and expenses paid in that case. But I seethed over it, because the arrogance of charging the estate for the shirt was as symbolic as it was real. If a lawyer thought that the estate owed him for a shirt, to what other expenses was this lawyer “entitled”?<sup>74</sup> In another case, we uncovered an attorney who was routinely generous in tips for restaurant meals—at a consistent rate of well over 20%. It's easy to be generous when the funds for the generosity don't come out of your own pocket.

Those sorts of errors are “kindergarten math,” to use Chip Bowles's phrase. I worry far more about the over-representation that I've already mentioned: overstaffing at hearings, high-billing partners drafting documents that junior lawyers should draft, spending thirty hours to draft a simple, eight-page motion, and so on.<sup>75</sup> Aside from contacting the billing lawyer responsible and asking for an explanation, there's no good check on that behavior. We've tried, in two cases in which I've been involved, to come up with a rubric to determine how professionals should spend their time, and the best rubric that I've developed is that professionals whose fees are estate-paid shouldn't perform services for their clients that are more extensive than those they would perform for clients who are footing their own bills. That's a nice theory, but there's no easy way to implement it.

There's an element of billing judgment that likely gets lost when professionals are paid from estate funds. To be sure, I don't believe that good lawyers rub their hands together greedily, anticipating “easy money” overcharging.<sup>76</sup> But I do believe that, in the hustle of a fast-paced, high-stakes case, people can make subconsciously different decisions from those that they'd make when they're facing the actual, bill-paying client because their fees are being paid by faceless participants in the process.

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74. Not only did the lawyer charge for the \$140 shirt, but he also deposed me about it (at an additional cost to the estate for everyone's time).

75. And don't get me started on how overpriced most junior associates' rates are, relative to their skill levels. Most tasks that junior associates do could be done better and more quickly by legal assistants. *See also* Elie Mystal, *Corporate General Counsel Puts Fear of God into Legal Educators (And You Should Be Worried Too)*, ABOVE THE LAW, Apr. 15, 2010, <http://abovethelaw.com/2010/04/corporate-general-counsel-puts-fear-of-god-into-legal-educators-and-you-should-be-worried-too/> (discussing the remarks of Chester Paul Beach, United Technologies's General Counsel, that first- and second-year associates are prohibited from working on any matter “without special permission, because they're worthless”).

76. I do think that the studies about billing conducted to date have omitted one source of pressure on bills: the internal pressure from the professionals' partners. As my colleague Geoff Berman has noted, some professionals may be overly cognizant of their partners' attitudes about their work. *See* Email from Geoffrey S. Berman, Shareholder, Greenberg Traurig, LLP, to author (Feb. 16, 2010) (on file with author). (I remember how some of the lawyers at my old firm made fun of the bankruptcy practice from time to time.) He suggests that the true test of the reasonableness of bills is “whether the lawyers have efficiently and effectively championed the cause(s) of their respective clients to reach an economical resolution for the debtor and creditors.” *Id.*

## II. SUCCESS FEES AND BONUSES

It's not just that the professionals can make decisions subconsciously that would differ from those they'd make outside bankruptcy representation. It's also that the compensation mechanisms that they establish can create distorted behavior.<sup>77</sup>

### A. What's Considered a "Success"?

Many fee arrangements, at least for financial advisors, involve some combination of a monthly rate and a "success fee" to be paid at the end of the case.<sup>78</sup> It's not a stretch to imagine that, unless "success" is clearly defined, there's an incentive to bring a case to a rapid end in order to claim that fee.<sup>79</sup> Moreover, if the professional's employment was approved under 11 U.S.C. § 328, rather than under

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77. Dickerson, *supra* note 31, at 367–68.

Few would argue that the Chapter 11 process now (with significantly more 363 sales, Chief Restructuring Officers ("CROs"), examiners, and concentrated large case filings in New York and Delaware) functions the same way it did in 1978 or even 1998. Thus, even if Delaware and New York cases do not have higher filing rates because of competition, or if every bankruptcy judge is a virtuous, dedicated public servant, few would dispute that large Chapter 11 cases now are different from the ones originally envisioned by Congress.

*Id.*

78. There are also such things as "tail fees," which provide that, for a period after the professional's services have terminated, the professional can still receive certain payments upon the occurrence of certain events. The "tail fee" in *In re Bigler* is an example:

[The financial advisor] shall be entitled to the fees enumerated in any preceding subparagraph of this paragraph upon the earlier of (i) the occurrence, during the term, or within twelve (12) months after the date of termination, of this Agreement (such twelve month period being referred to as the "Tail Period"), of a Financing Transaction, a Restructuring Transaction, an M & A Transaction or other Transaction or (ii) [sic] the occurrence of any Transaction specified in any such subparagraph with respect to which an agreement to consummate such transaction was executed by the Company during the term or within the Tail Period.

*In re Bigler*, LP, 422 B.R. 638, 641 (Bankr. S.D. Tex. 2010) (quoting the Engagement Letter to Parkman Whaling LLC). The purpose of a tail fee is to prevent the client from taking the benefit of the advisor's work and then terminating the advisor before paying any fee. In approving the tail fee in *Bigler*, the court found:

At first blush, this Court has concerns with the Tail Period because it provides an avenue for Parkman Whaling to receive a fee even though its services have not resulted in a tangible, identifiable, material benefit to the Debtors' estate. Given this possibility, this Court concludes that there is a presumption of unreasonableness in any proposed retention by a professional who requires a tail period in addition to the other requested categories of compensation—such as, for example, a monthly fee in a fixed amount.

*Id.* at 643. The court found that the testimony at trial rebutted the presumption of unreasonableness. *Id.* Moreover, the statutory mechanism under which the financial advisor was applying allowed the court to review the final fee request for reasonableness. *Id.* at 644–45.

79. In a conversation that I had with someone nationally known in the field of corporate restructuring, he discussed that point—and that companies that might have actually reorganized were sold quickly instead. I also asked Lynn LoPucki if any of his data had separated out success fees from other fees. In one of his usual, extremely cordial, emails to me, he explained that his studies had not collected separate information on success fees, although he did have data on transaction fees. Email from Lynn LoPucki, Security Pacific Bank Professor of Law, UCLA Law, to author (Feb. 1, 2010) (on file with author).

11 U.S.C. § 327, the bankruptcy court has limited discretion to unwind a pre-approved fee.<sup>80</sup>

There certainly are transaction fees that courts approve as part of the cost of advising the DIP or a court-approved committee.<sup>81</sup> Some of the fees, if converted to hourly rates, would be considered “shockingly high” by any standard.<sup>82</sup> But the question is not whether the fees are, in themselves, too high. The question is whether a client who would have to foot the entire bill would think that the fees were reasonable, given the end result.<sup>83</sup> We have to add one additional question,

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80. Under § 328(a), the court may disallow the compensation only “if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.” 11 U.S.C. § 328(a) (2006); see also *In re Mirant Corp.* 354 B.R. 113, 127 (Bankr. N.D. Tex. 2006).

Under the agreements reached by the financial advisors with their clients, each financial advisor was entitled to a monthly fee (which has been paid on a regular basis) as well as expenses. Each financial advisor also negotiated a “success fee,” to be paid in the event of a successful end to the Debtors’ cases. Not surprisingly, “success” (usually referred to by the Applicant as “restructuring” or a “transaction”) is defined broadly by the financial advisors.

*Mirant*, 354 B.R. at 127.

81. *Rise of the Financial Advisors*, *supra* note 3, at 167.

Examination of the seventeen fee applications reveals that in almost every instance—including one in which the financial advisor worked for the creditors’ committee—the bulk of the award was a “transaction fee,” a fee fixed as a percentage of the assets to be reorganized or sold. The fee was earned on consummation of the sale or reorganization. The fee application recited the number of hours worked from the commencement of the case to the date of the post-confirmation application and the amount of the fees due under the employment contract. In none of the seventeen representations in Table 13 did the application indicate a blended hourly rate, as the U.S. Trustee’s guidelines recommend.

*Id.*

82. *Id.* at 172–73.

DIPs pay substantial amounts to professionals who represent and advise secured creditors and DIP lenders. These professionals are not required to participate in the visible fee award system, and so their fees are not reflected in the findings of this study. We were, however, able to estimate the amounts DIPs paid them. If we include those amounts, DIPs paid 57% for professionals they employed, 30% for professionals secured creditors and DIP lenders employed, 13% for professionals creditors’ committees employed, and only 1% for professionals equity committees and courts employed. To the extent that fees are a proxy for power, DIPs still dominate the bankruptcy reorganization process.

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Surprisingly, whether the debtor sold its business or sold some interest in its business had no significant effect on DIP financial advisors’ fees. The DIP’s financial advisors do not make significantly more money when the DIP sells its business through bankruptcy.

We found fee awards to investment bankers at shockingly high rates—up to \$18,000 per hour. Although the investment bankers typically commenced work pre-petition, their applications did not report pre-petition hours worked. Nor did those applications show post-petition hourly rates. If hourly rates are relevant, the fees awarded are too high. If hourly rates are not relevant, the system should not require the investment bankers to keep and report their hours.

*Id.* (footnote omitted).

83. Cf. *Perdue v. Kenny A. ex rel. Winn*, No. 08-970, 2010 WL 1558980, at \*7 (U.S. Apr. 21, 2010) (“[A] reasonable attorney’s fee is one that is adequate to attract competent counsel, but that does not produce windfalls to attorneys.” (alteration in original) (quoting *Blum v. Stenson*, 465 U.S. 886, 897 (1984))).

though: if success fees tend to create incentives to flip a company or its assets quickly, rather than to take the time to attempt a reorganization of the company's business, are those success fees such a good idea in terms of bankruptcy policy? There's no clear answer.

*B. Shouldn't a Bonus Mean That the Professional Has Done More Than His Job?*

At the close of Chapter 11 cases that have gone very well (for example, 100% payouts to unsecured creditors and money left over for equity), many professionals ask for bonuses as part of their final fee applications. I understand the reason for the request. Everyone's happy about the case's outcome, and everyone had a role in achieving such a good result.

But I have a nagging sense that most bonuses aren't earned, at least not in the sense in which I think of a bonus. I think of a bonus as a reward for work that goes far beyond what the original agreement between two parties had contemplated. Most fees contemplate fair pay for hard work.<sup>84</sup> Why, if a professional has done his job, should he get paid twice for the same work—the contracted-for fee and for a bonus to boot? I'm not alone in doubting the double-dipping nature of such a request. In a recent case involving a request for fee enhancement in a civil rights case, the Supreme Court was skeptical about how often attorneys would be able to demonstrate that they deserved such enhancements.<sup>85</sup>

Maybe we've caused clients to adjust their expectations downward regarding professionals' performance standards. I recently heard the general counsel of a company explain how happy he was when one of his outside counsel suggested to him that, instead of paying hourly rates for years of litigation, the lawyers could

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84. These hourly fees can be pretty high: upwards of \$800/hour for some of the largest firms. Tied to those high rates is an implied ability to handle complicated matters competently. Doing that for which one has already been well-paid shouldn't, in itself, trigger a bonus. In other words, pulling a rabbit out of a hat at the price at which one regularly pulls rabbits out of hats shouldn't trigger a bonus; however, pulling a rhino out of that hat perhaps should merit one.

In a Supreme Court case that came out just as this issue was going to print, the majority opinion reiterated that "an enhancement may not be awarded based on a factor that is subsumed in the lodestar calculation . . ." *Perdue*, 2010 WL 1558980, at \*7. For the Supreme Court's discussion of the lodestar factors in this case, see *id.* at \*9–\*10.

85. In *Perdue*, the Supreme Court addressed the question of "whether either the quality of an attorney's performance or the results obtained are factors that may properly provide a basis for an enhancement," and it "treat[ed] these two factors as one" in its majority opinion. *Perdue*, 2010 WL 1558980, at \*8. The majority, observing that many factors could contribute to a "superior" result—including the relatively "inferior performance by defense counsel, . . . unexpectedly favorable rulings by the court, an unexpectedly sympathetic jury, or simple luck[.]" *id.*,—held that attorneys seeking fee enhancements in civil rights actions would have to prove that the superior results achieved in the case were "the result[s] of superior attorney performance," rather than being attributable to any other factors. *Id.* In order to demonstrate such superior performance, the attorney requesting the fee enhancement would have to demonstrate that the lodestar calculation "would not have been 'adequate to attract competent counsel.'" *Id.* (quoting *Blum*, 465 U.S. at 897). Even more telling, the majority opinion states flatly that "[t]here is nothing unfair about compensating these attorneys *at the very rate that they requested*." *Id.* at \*9 n.7 (emphasis in original).

settle the case quickly, if the general counsel would consider paying a bonus for the fast work.<sup>86</sup> Quite frankly, I was stunned: I thought that lawyers were *supposed* to do the best job that they could for their clients, including achieving quick settlements, without needing a bonus payment.<sup>87</sup> After all, by settling a case early and at a good price, those lawyers are freed from the obligations of preparing for a long trial. They can then turn their attention to other paying jobs. So why should they get paid extra for doing what their own ethics rules require them to do: provide competent, diligent work for reasonable fees? In other words, if a professional hasn't bargained for a fair fee on the front end, why should he get a second bite at the apple at the end of the representation?

On the other hand, there are situations in which some professionals have achieved a stunning result, and that result is clearly attributable to those professionals' talent and effort.<sup>88</sup> Therefore, under some limited circumstances, bonuses could be appropriate. At the minimum, though, those circumstances should include only those cases in which the results are dramatically better than anyone had a right to expect. Bonuses within Chapter 11 cases should mirror those situations in which a happy client outside bankruptcy would be willing to pay her professionals a bonus. Professionals shouldn't get bonuses for doing that which they're contractually and ethically obligated to do.<sup>89</sup>

### III. THE LAKE WOBEGON EFFECT AND THE OVERVALUATION OF SERVICES

In the midst of our nation's current recession, the idea that professionals should be entitled to high fees merely because every other professional in that field charges high fees is more than a tad grating.<sup>90</sup> University presidents,<sup>91</sup> C-level officers,<sup>92</sup>

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86. Lee Cusenbary, Gen. Counsel of Mission Pharmacal Co., Remarks at the 9th Annual Symposium on Legal Malpractice and Professional Responsibility, St. Mary's University School of Law (Feb. 19, 2010).

87. Of course, I also believe that law professors shouldn't be rewarded for publishing the equivalent of an article a year, because that is part of what they're paid to do. Their salaries cover producing regular scholarship and providing a good education to their students, so they shouldn't get bonuses merely for doing their jobs.

88. See, e.g., *In re Mirant Corp.*, 354 B.R. 113, 147–48 (Bankr. N.D. Tex. 2006) (awarding a fee enhancement for counsel for the Equity Committee, counsel for the Examiner, and the Examiner himself).

89. I didn't ask for a bonus in the case in which we found the high conflicts check. See *supra* note 72. We were just doing our job, and we happened to find that line item. Nor do I expect a bonus in a year in which I teach a little better than I usually do, or in which I publish more than I usually do. I don't work hard at my job because I'm expecting a bonus at the end. I work hard at my job because I value my reputation and because I'm a professional.

90. Cf. WILLIAM SHAKESPEARE, *THE LIFE OF HENRY THE FIFTH* act 4, sc. 1 ("FLUELLEN If the enemy is an ass and a fool and a prating coxcomb, is it meet, think you, that we should also, look you, be an ass and a fool and a prating coxcomb? In your own conscience now?").

91. Cf. Ellen Gibson, *The Top 10 at Public and Private Colleges*, BUS. WK., [http://www.businessweek.com/bwdaily/dnflash/content/feb2009/db20090216\\_614557.htm](http://www.businessweek.com/bwdaily/dnflash/content/feb2009/db20090216_614557.htm) (last visited Apr. 17, 2010) (noting the median pay for public-school University presidents in 2007–08 was \$427,400 and was \$100,000 more at private colleges).

92. Cf. David Goldman, *The Top 10 Highest-Paid CEOs Are . . .*, CNNMONEY.COM, Aug. 14, 2009, [http://money.cnn.com/2009/08/14/news/companies/highest\\_paid\\_ceos/](http://money.cnn.com/2009/08/14/news/companies/highest_paid_ceos/) (reporting that seven chief executives earned more than \$100 million in 2008).

employees of bailed-out companies, and, yes, bankruptcy professionals all want to be paid fairly for their knowledge and skill, but the market rate for those skills may not be so easy to establish. High fees may often be the norm,<sup>93</sup> but why?

Clients can often mistake high fees for high quality.<sup>94</sup> But not everyone who charges high fees is consistently good, and not everyone who charges a relatively low fee is bad. But there's a Lake Wobegon effect: we pay high fees for all of our professionals, and so "all of our [lawyers] are strong, all of our [reorganization officers] are good-looking, and all of our [advisors] are above average."<sup>95</sup>

In the highly competitive world of Chapter 11 representation, there are some professionals who are truly "name brands," and whose skill levels are high enough to justify their fees. Others, who may be quite good, haven't yet broken into the ranks of the nationally known, and it may be more difficult for them to get the highest-profile cases. Considering that people are choosing their professionals at a time when delay can be prejudicial to parties' rights, it's no surprise that the first professionals tapped are the best-known ones. The fact is, though, that even the best professionals can't be at the top of their game all of the time. Unfortunately, there's no fix for the link in clients' minds between high fees and high quality, other than to have some awareness that the relationship between fees and skill isn't linear.

#### IV. WHERE WE MIGHT LOOK FOR SOLUTIONS

The problem with monitoring estate-paid fees in larger Chapter 11 cases is that the pressure to represent fiduciaries well tends to generate additional work and overstaffing, and the bankruptcy court can easily be overwhelmed with the task of reviewing those fees. Moreover, the clients of those professionals, who normally might be able to provide input to the court about the reasonableness of those fees, may not have the knowledge base to supply useful information. It's the interaction of these several factors that causes fees in some cases to be unreasonable:

- (1) the disconnect between the professionals doing the work and the clients receiving the bills, caused by the fact that no client will have to pay 100% of the fees and expenses on those bills;
- (2) the fear of dropping the ball when representing a fiduciary;

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93. *In re Bigler, LP*, 422 B.R. 638, 640 (Bankr. S.D. Tex. 2010) ("It may well be that such a fee is the norm in the investment banking community. The Court wants to emphasize . . . that it will not approve requested terms of retention merely because the terms are routine in the investment banking community. Greater justification needs to be given to obtain approval.").

94. I'm being a bit hypocritical here because I charge a very high rate for consulting engagements. I charge that rate in part because I don't want to take on a lot of consulting gigs, which necessarily take me away from other work and from my family. Some clients pay that rate, and some go elsewhere. I don't believe that I'm necessarily "worth" what I charge, especially when I consider what rates other types of highly trained professionals might charge. But I try to give good value for my fees.

95. *See supra* note 12.



(3) the fact that relatively few of these client-fiduciaries themselves are repeat players in the bankruptcy system, and the matters being billed may be quite puzzling to them;

(4) a deep distrust of the work done by other parties' professionals, so that each constituency wants to hire its own professionals;<sup>96</sup>

(5) a reluctance on the part of any professional to micromanage other professionals' decisions by filing objections to fees; and

(6) a tendency to want to choose "name brand" professionals, rather than less well-known professionals, so that the choice won't be second-guessed later.

Even the best-intentioned of professionals in Chapter 11 cases may succumb to over-representation from time to time, as well as to the incentives that success fees and bonuses might trigger. We know that it's difficult for the clients of these professionals to be able to put all of their professionals' bills in context, so that they can determine whether those bills are reasonable, and we know that time-crunched courts, as well as the Office of the U.S. Trustee, can't literally review every line of every bill in every case.<sup>97</sup> So what are some options for dealing with the nagging sense that professional fees in Chapter 11 aren't always as reasonable as they should be?

#### *A. The Tabb Proposal: Normalize and Limit Professional Fees*

Professor Charles Tabb has suggested that some national uniformity of fees may be in order, not just to avoid any allegations that professionals are forum-shopping for their own self-interest,<sup>98</sup> but also as a way of reducing the public's image of bankruptcy professionals at the feeding trough.<sup>99</sup> Courts normalize fees all the time in consumer cases by for example, creating no-look fees.<sup>100</sup> There's nothing to stop a court from establishing no-look fees for stay relief motions or other types of work that tends to stem from regularly occurring sets of facts.<sup>101</sup> As a matter of fact, I'm

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96. I see this factor play out the most with financial advisors.

97. Professors Lynn LoPucki and Joseph Doherty consider some of the methods that bankruptcy courts are using to deal with the review of professional fees to be illegal. See generally *Routine Illegality*, *supra* note 3.

98. Tabb, *supra* note 31, at 494–95.

A related means of combating the ill effects of competition is to limit professional fees and to normalize them across the country. . . . Congress could counter this incentive by imposing fee caps of some sort, as well as by imposing greater uniformity in fees allowed across the country. If attorneys knew that by statute, they could not do better on fees in Delaware than in the debtor's real home court, that basis for shopping would fall away.

*Id.*

99. *Id.*

100. See, e.g., *In re* Chapter 13 No-Look Fees, General Order No. 2007-2 (Bankr. E.D. La.), available at <http://www.laeb.uscourts.gov/RuleOrders/RulesOrders.htm>. Other courts have used budget caps for particular professionals as well.

101. For that matter, there's nothing to stop a court from capping the fees for bankruptcy partners, associates, and paralegals at the same rate that their non-bankruptcy colleagues in the same firm charge, so that

tempted to do a study sometime of what various activities cost in large Chapter 11 cases, just to see if we could standardize some of these fees.

As Professor Tabb himself recognizes, though, national fees and stricter billing standards won't prevent the big-picture types of problems that this essay addresses.<sup>102</sup> He suggests, instead, moving away from a billable-hours determination of value to a more holistic payout:

*The other would be for courts to . . . shake the "time is money" mentality and look at what is left in the estate, and what the lawyers did to bring that about . . .*<sup>103</sup>

*If lawyers knew that they would ultimately be answerable (in terms of their fees allowed) for the value of the estate, and that their recovery would be based on a percentage of the estate, several positive things might happen. If the case did not look promising, lawyers would not be inclined to pour a lot of time into that case in a probably vain attempt to reorganize. This could lead to quicker termination of doubtful cases. Furthermore, even promising cases might be concluded more quickly, with less delay in negotiations. The lawyers would know that they would not necessarily be compensated for every hour spent, and thus would have no reason to churn hours. The moral hazard inherent in a pay-by-the-hour system would largely be obviated.*<sup>104</sup>

A percentage payout or another type of compensation that reduces the incentive to over-represent their clients makes sense. Moving away from billable hours compensation to the types of flat fees that other, non-bankruptcy clients are starting to demand<sup>105</sup> is not a pipe dream, either. I've seen fee caps and flat fees ordered, such as this one in *In re Kobra Properties*:

*The Amended Employment Application is GRANTED on the terms and conditions contained in this Order, and pursuant to Bankruptcy Code*

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a bankruptcy department can't charge a premium over its firm's other rates. See, e.g., *In re Fleming Cos.*, 304 B.R. 85, 92–93 (Bankr. D. Del. 2003) (requiring the firm to produce the hourly rate schedule "of all its attorneys and paralegals in all practice areas and offices"); see also Sidney P. Levinson, *Can Bankruptcy Lawyers Charge Higher Billing Rates Than Their Non-Bankruptcy Counterparts?*, 062404 AM. BANKR. INST. HAW. BANKR. WORKSHOP 161 (2004) (noting the significance of the *Fleming* decision in light of "the prevalence in law firms of different billing rates for bankruptcy and non-bankruptcy lawyers of 'similar experience'").

102. In fact, there's always a risk of setting the fee too high for the type of work contemplated. But we need to choose between the risk of setting too high a fee and the risk of putting no real limits on fees.

103. Tabb, *supra* note 31, at 495 (quoting Charles J. Tabb, *The Future of Chapter 11*, 44 S.C. L. REV. 791, 842–45 (1993)).

104. *Id.*

105. See, e.g., *New Fee Structure for Law Firms*, FORBES.COM, Apr. 29, 2009, <http://www.forbes.com/2009/04/29/billable-hour-retainer-entrepreneurs-law-taxation-wharton.html> (reporting that the financial crisis caused law firm clients to challenge law firms' use of billable hours).

*Section 327 and Federal Rule of Bankruptcy Procedure 2014(a), the Debtors are authorized to employ Shulman Hodges & Bastian LLP ("Firm") as their general counsel in these cases with compensation to be paid as an administrative expense of the Estates in such amount as the Court may hereafter allow in accordance with law and in accordance with the following conditions and procedures for payment of the Firm's compensation:*

*a. Pursuant to 11 U.S.C. § 328(a), the Firm's compensation as attorneys for the Debtors in these Chapter 11 proceedings shall be on a fixed fee basis of \$1,200,000 ("Fixed Fee"), plus costs.*

*....*

*d. The Debtors shall be authorized to pay additional amounts to the Firm towards the Fixed Fee without further notice hearing or Court order, provided that the Firm provides not less than 7 days notice to the following parties of the additional monies received towards the Fixed Fee as it is received from the Debtors or from Future-Debtor Sources (defined hereinafter) until such time as the Fixed Fee has been paid in full: the Office of the United States Trustee ("UST") the members of the Committee and its counsel, the secured lenders in the case and their counsel, and parties requesting special notice.<sup>106</sup>*

The advantage of a fixed fee is that it puts the onus of deciding the cost-effectiveness of an activity on the person whose bottom line is affected: the professional. The disadvantage, although it's not a major disadvantage, is that the size of the fixed fee could end up being woefully low for the amount of work that the professional needs to do, resulting in the professional having to finish up the job for free.<sup>107</sup>

Would the name-brand players be willing to play ball for a fixed fee, or would they abandon bankruptcy practice for some other area? Financial advisors accept fixed fees (and the issue there is defining on what grounds the fee should be triggered), but lawyers are often reluctant to depart from their hourly rates.<sup>108</sup> Testing the waters in this regard should be interesting.

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106. Final Order Regarding Employment of Shulman Hodges & Bastian LLP as General Counsel at 3–4, *In re Kobra Properties*, 406 B.R. 396 (Bankr. E.D. Cal. 2009).

107. A related approach could include the creation of a local rule requiring the use of local counsel, rather than "name-brand" counsel, absent a showing of extraordinary need. Other than on the coasts, where legal fees tend to be high, see *supra* note 37 and accompanying text, such a rule might work to suppress some of the overspending on hourly fees that goes on, although the rule wouldn't necessarily have an effect on overstaffing. But if bankruptcy courts were to go this route, such a rule would have to be a national rule to avoid unfairness or, yes, forum-shopping.

108. I've spent years arguing that law firms are going to have to abandon hourly billing eventually (or drop the high compensation levels) because the numbers just don't crunch well any more. See *Law Firm Economics*, <http://nancyrapoport.blogspot.com/search/label/Law%20firm%20economics> (listing several blog posts con-

*B. Forcing the Group Incurring the Costs to Bear All of the Fees—the Baker Approach*

Professor Cynthia Baker has suggested that the way to avoid the problems associated with having the estate bear the costs of particular groups' professionals is to change the administrative priority status for those fees and expenses. For example, instead of having the fees for the unsecured creditors' committee come "off the top" as an administrative expense, Professor Baker suggests that those professionals' fees come out of the distribution to unsecured creditors.<sup>109</sup> For DIP professionals, the payment scheme would be a little trickier:

*The proposed system would allocate professional costs incurred by the DIP among all classes of unsecured claims and equity interests in proportion to the value of the property distributed to each class under the plan of reorganization. The precise allocation of the DIP's professional costs could be left to agreement among the parties if the plan is consensual, and based strictly on distribution values if cramdown of the plan is required.*<sup>110</sup>

Professor Baker's elegant proposal is inherently appealing in many ways. She captures perfectly one of the main problems with our current system—namely, that those incurring the costs inevitably are spending other people's money. It places the risk of overspending and overstaffing squarely within the realm of those on whose behalf the overspending and overstaffing is done. If we were to revamp the Bankruptcy Code along the lines that Professor Baker suggests, we might well reduce the amount of unreasonable fees being incurred.<sup>111</sup> Until then, though, we're stuck with tweaking the current system.

*C. The Harner "Single Estate Representative" Approach*

Professor Michelle Harner has proposed a significant change to Chapter 11 by "replacing all statutory committees with an estate representative."<sup>112</sup> As she explains:

*[T]he Bankruptcy Code could direct the estate representative to fulfill its fiduciary duties to the bankruptcy estate by working with the debtor to maximize the value of the estate, first by exploring the debtor's*

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cerning the billable hour). Of course, if every firm abandons hourly billing, then fixed fee caps in Chapter 11 cases won't look so bad. That abandonment isn't likely to happen, though.

109. See Baker, *supra* note 8, at 457–62. In other words, "[p]rofessional fees would have the same overall priority vis-à-vis other claimants as the constituency represented, but would take priority over claims within that class." *Id.* at 459. Of course, Professor Baker's actual proposal has more details than those that I'm describing here.

110. *Id.* at 462–63.

111. I'm not sure how her proposal would work in carve-out situations, though.

112. Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 108 (2008).

*reorganization opportunities; second by exploring a going-concern or orderly sale of the debtor; and finally by exploring the liquidation of the debtor under either chapter 11 or chapter 7 of the Bankruptcy Code. The estate representative could both assist the debtor in possession in formulating a chapter 11 plan and monitor the activities of the debtor and its creditors and shareholders.*<sup>113</sup>

Although her reasons for proposing the substitution of an estate representative speak more to dealing with the effect of distressed debt investors' interests on a reorganization, it has occurred to me that having a single estate representative to assist the DIP could avoid the potential multiplicity of duplicative activities when each fiduciary has its own lawyers and financial advisors.

Such a change would likely be hard-fought. The interests of unsecured creditors differ in kind from the interests of, say, equity holders, and spelling out how a single estate representative might handle the balancing of interests will be tricky. As Professor Harner explores this idea further, I'll be following it with interest.

#### *D. Limiting the Number of Professionals Working on a Case*

I've been tempted to suggest some sort of limit on the number of professionals in a case, but I believe that such a limit may prove to be unworkable. Every case is different, and each case has twists and turns that develop over time, depending on the decisions made by the various parties in interest in the case. I've also been tempted to suggest that not every fiduciary needs its own financial advisor (although I won't say that fiduciaries could share attorneys—that would create serious conflicts of interest). Perhaps in some cases, one party (the DIP) could pay full freight for a financial advisor's work, and other parties in interest could hire financial advisors for the limited purpose of reviewing the primary financial advisor's work. Again, such a proposal might work in some situations, but an across-the-board rule unfortunately makes no sense.

#### *E. Follow the Lead of Other Practice Areas That Deal with the "Missing from the Table" Phenomenon*

Other practice areas have professionals who represent fiduciaries, where the fiduciary sitting across the table reading the professional's bill isn't the party who will have to pay the entire cost of that bill. Probate cases come to mind,<sup>114</sup> as do class actions.<sup>115</sup> Other analogous situations might involve insurance defense cases, court-

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113. *Id.* at 108–09 (footnote omitted).

114. Thanks to Tom Russell for pointing this out. Email from Thomas D. Russell, Professor at Sturm College of Law at the University of Denver, to author (Feb. 16, 2010) (on file with author).

115. For an interesting take on fiduciary duties in securities law class actions, see Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. 1239.

appointed defense lawyers,<sup>116</sup> or cases in which the victor might receive a statutory fee award.<sup>117</sup> As a matter of fact, in the recent *Perdue v. Kenny A. ex rel. Winn* case, the majority opinion pointed out just why courts should be cautious in awarding fee enhancements for the attorneys representing prevailing parties in civil rights cases:

*Section 1988 serves an important public purpose by making it possible for persons without means to bring suit to vindicate their rights. But unjustified enhancements that serve only to enrich attorneys are not consistent with the statute's aim.*

*In many cases, attorney's fees awarded under §1988 are not paid by the individuals responsible for the constitutional or statutory violations on which the judgment is based. Instead, the fees are paid in effect by state and local taxpayers, and because state and local governments have limited budgets, money that is used to pay attorney's fees is money that cannot be used for programs that provide vital public services.*<sup>118</sup>

In essence, the Supreme Court recognized the “missing from the table” phenomenon here, albeit in a different context. All of these other areas of law touch on the problems that I’ve asserted in this essay, and none of them have completely resolved the “missing from the table” issue.

#### *F. More Vigorous Use of State Ethics Rules on Reasonableness of Fees*

Every lawyer practicing in federal bankruptcy court holds at least one state bar card, and every state has an ethics rule regarding the duty of a lawyer to keep fees reasonable. It’s possible that bankruptcy courts could refer cases of exorbitant fees to state bars for disciplinary action, but I’ve not seen many state bars that enjoy dealing with bankruptcy lawyer misbehavior at all, let alone enjoy parsing whether fees in a bankruptcy case were reasonable.<sup>119</sup> This idea, I’m afraid, is a non-starter.

#### *G. Better Use of Fee Examiners?*

There are several different types of fee examiners. Some have extensive computer programs that will enable them to compare line items from various professionals’

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116. Email from Ronald Stutes, Member, Potter Minton, to author (Feb. 17, 2010) (on file with author).

117. Email from Bernard Burk, Director, Litigation Department, Howard Rice Nemerovski Canady Flak & Rabkin, to author (Feb. 16, 2010) (on file with author).

118. *Perdue v. Kenny A. ex rel. Winn*, No. 08-970, 2010 WL 1558980, at \*10 (U.S. Apr. 21, 2010) (footnote omitted).

119. I was involved as an expert witness (for the state) in an Ohio disciplinary case, eons ago, and I’ve offered to be a resource for other bars. I think that state bars get very nervous about the disciplinary proceedings of bankruptcy lawyers, given their general unfamiliarity with the area.

entries in order to determine any duplication of effort or misattribution of time. Others don't use computers, relying instead on visual review of entries and other ways to ballpark "reasonableness." Whether fee examiners are useful at all is an open question, as Professor Lubben explains:

*Model 6 [of the Lubben study] considers the use of fee examiners. I find no effect from the participation of a fee examiner or auditor in a case. Given that my dependent variable, total fees and expenses requested in the case, is exclusive of court appointed neutrals like trustees and examiners, this suggests that the use of a fee examiner imposes a positive cost on the estate. This indicates that the benefits of fee examiners, if any, come from administrative assistance they offer the bankruptcy court and not from any direct cost savings in the case.*<sup>120</sup>

Moreover, as Professor LoPucki rightly points out, no fee examiner will ever be able to ferret out billing misbehavior, such as billing more time than the professional actually worked.<sup>121</sup>

Based on my own experiences as a fee examiner, I believe that the usefulness of such a position doesn't depend on catching serious billing errors<sup>122</sup> as much as it does in talking with the respective professionals about why they chose to undertake certain activities. Using a fee review committee<sup>123</sup> in conjunction with a fee examiner may tease out additional information about why the various professionals chose to undertake certain actions in their representation. For example, having a member of an official committee review a monthly bill along with me helps me to understand whether the professional who submitted the bill was doing work that the committee itself understood to be both authorized and useful. The three-step process that I use—review the bill, send the review to the fee review committee to see if anyone has anything to add, and send the review to the professional seeking compensation—is an attempt to distill the reasonableness of the fees requested.<sup>124</sup>

I view my role as helping the court in its ultimate determination regarding the reasonableness of fees. I know that I'll be called on to testify whether I think that the fees in a case were reasonable, and so I spend time looking at big-ticket items,

120. Lubben, *supra* note 3, at 109.

121. *Routine Illegality*, *supra* note 3, at 427–28.

122. With responsible professionals, there just aren't very many errors. Instead, there tend to be disagreements as to whether an action has benefitted the estate or whether an expense is properly chargeable to the estate.

123. In both of the fee review committees that I've chaired, the committee was composed of non-lawyer representatives of the debtor and of each official committee, with the U.S. Trustee's Office acting as an *ex officio* member.

124. The students who help me review bills are very good at catching expenses that don't mesh with the guidelines for those expenses, and the students are often quite good at identifying projects that seem to have taken too much time or seem to have been staffed inappropriately.

reviewing any corresponding written work product, and asking professionals about their decisions. I use law students, who (like me) are paid by the estate, to help me sort out which entries in a bill are big-ticket entries and which ones are minor, based on parameters that I've given them.

The disadvantage of my work as a fee examiner is that I'm not in court during the case. I'm removed from the action. Therefore, having a fee review committee composed of representatives of the DIP and any committees is crucial. I need to be able to talk with those representatives about their perceptions of how the case is progressing and their own sense of time spent on various actions. And the participation of a representative from the Office of the United States Trustee has been essential to me. That person, unlike me, has seen the day-to-day activity in the case and is able to help me sort through questions about particular choices that professionals have made.

Only the parties in interest and the court can decide if my work as a fee examiner is useful in the long run. It's possible that appointing a fee examiner is useful as an *in terrorem* device—a way of keeping professionals on their toes—although I doubt that's my primary usefulness.<sup>125</sup> (It's also possible that increasing the use of fee examiners might create forum-shopping to avoid those courts that use them, but that's a remote risk these days.) The professionals with whom I deal have a keen grasp of their contractual and ethical obligations, and they don't need to have a law professor like me remind them of those obligations. At best, I'm a neutral, like the court and like the U.S. Trustee, designed to help the system by asking questions that might lead to reconsideration of the advisability of certain activities. I help at the margins, and I wonder all the time whether that is enough.

#### CONCLUSION

There's no question that Chapter 11 bankruptcy practice can be lucrative for the lawyers and other professionals involved, or many of the bright minds who work in Chapter 11 would find other ways to occupy their time. Whether the practice is too lucrative depends on who's asking the question, and my biggest fear is that there are too many barriers to finding the real answer. There are internal pressures that tend to encourage over-representation of those clients who are fiduciaries of their constituencies, and there's no easy way for anyone—even the bankruptcy judge—to take the 30,000-foot view of the professionals' decisions in a case to determine if those decisions were the right ones. The only test that I've found that captures the issue is the one that asks whether a client who was paying the bill out of his own pocket would think that the decisions were reasonable. It's not a perfect test, by any means, but it's a start.

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125. Not that I can't be scary. I think I can. Ask my law students.



